Global Markets Strategy Report

March 2010

Rank: From weakest to strongest in ascending order:

Strong Underweight | Underweight | Slight Underweight | Neutral | Slight Overweight | Overweight | Strong Overweight

Please note that the rank is indicative and may not balance when summed.

Tighter Fiscal Policies May Hurt Europe's Recovery

→ Our base scenario of Economic Strength is confirmed by the persistence of low inflation, which enables major central banks to keep loose monetary policies in place even in an economic upturn. Key interest rates are expected to be raised in the US this year but at a comfortable pace and without getting into a tightening mode.

→ Our estimates for US economic growth have improved thanks to further evidence of a turnaround in the labour market. However, if America's GDP managed to grow by 3% this year, it would not recover, in US dollar terms, to the size that it was before the crisis that erupted in the second half of 2008.

→ Against this backdrop loose economic policies had better be maintained for as long as possible, although the most unconventional tools, such as quantitative easing, will start to be unwound soon.

→ For this reason, to abruptly restore tight budget policies in countries whose recovery is most fragile may hurt their growth prospects. This is the case for most of Europe and notably the eurozone where the need to respond to treaty provisions and market forces is prompting premature fiscal tightening in some recession-hit peripheral countries in the wake of the Greek crisis.

→ We took this risk into account as we refrained from extending our improved calls on US and emerging equities to Europe as a whole. In the latest update, we have even cut our strategic exposure to Europe and added to the US. This move leaves out European companies deriving most of their earnings from abroad, which may benefit either from stronger global growth or from a more competitive exchange rate.

Portfolio Strategy

On Fixed Income we still favour non-government bonds even without expecting further steep declines in credit risk premiums, notably for corporate bonds after last year's impressive rally. We maintain that current credit spreads correctly reflect lower default rates as a result of the economic upturn, and we see the best risk-reward ratios at the short end of the market where carry trades can be effectively played.

However, a new approach to credit risk is showing up in the markets. Investors used to focus on corporate solvency but lately they are putting renewed emphasis on government accounts. Government bonds have been a safe haven throughout the recession with only minor spread widening affecting non-core countries. That is why

PIONEER Investments®

the recent turbulence in a developed area such as the Eurozone marks a turning point, although we believe that fears of a sovereign default are overdone. For their part, core markets are unlikely safe havens when the interest rate risk enters the picture: yields have been kept low by very loose monetary policies that will be unwound this year and that may undermine support.

On Equities we are strengthening our positions in favour of US and Emerging Markets, where we believe the road to a full-fledged recovery will be shorter than in Europe and Japan. Our overexposure to the US implies that corporate profitability will also improve for industry groups more reliant on domestic household spending, therefore adding to overall earnings growth. As a result, government bond yields will rise moderately as inflation remains under control. A structural increase in government debt will not prompt a sharp rise in bond yields if, as we believe, US political parties broadly agree about the need for budget consolidation.

Profit-taking early this year on Emerging Markets prompted better valuations after a massive, but little selective, rally last year. The Asian region provides the best opportunities if, as we believe, China's hectic growth does not overheat and monetary authorities' efforts to cool down the excessive bank lending are successful. Latin America may also benefit from its exposure to Asia, notably with commodity exporters, while most of Eastern Europe looks overly reliant on Europe's still-uncertain growth outlook. European equities' market averages may be sustained by a better global growth outlook but exporters may benefit the most.

Our Investment Phazer*

Recovery in earnings per share and no fears of inflation favour cyclical assets

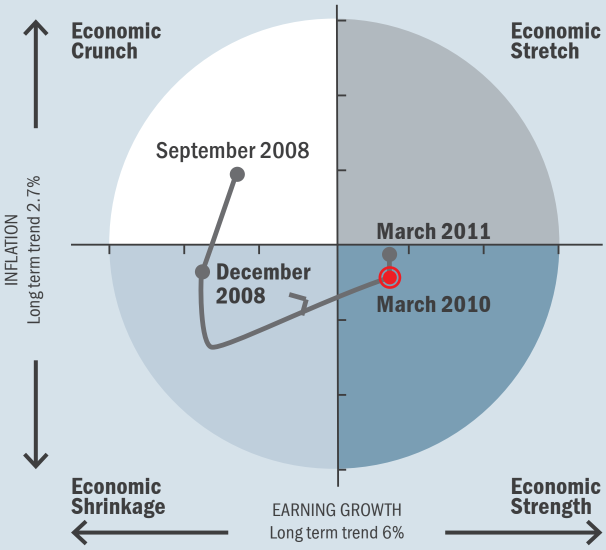
Economic Strength

The stabilisation and the progressive improvement of the financial outlook began in the second half of 2009 and is confirmed. In September 2009, we hit the turning point for US earnings momentum, while inflation does not represent a threat over the next 12 months. This case has been enhanced by our recently upgraded figure for US GDP growth.

Profit Recovery

Earnings growth is again in the front seat. The next upgrade will be when sales revenues start to grow convincingly. We will get there as the macroeconomic scenario improves, even marginally. According to our indicator there is a 75% probability for that to happen.

The Investment Phazer



(*) Data on US Earnings Growth and US Inflation are analysed by a proprietary statistical model to get four different economic phases. Source: Pioneer Investments Asset Allocation Research as of 26 January 2009

Implied Strategy

We name 'Economic Strength' as a phase with above-trend operating earnings and below-trend inflation expectations. Over the last 30 years this environment has called for risky assets. The current stance leads to an overweight of global equities and investment-grade corporate bonds.

Alternative Scenario

The main risk case is that the economy is unable to grow without the help of loose economic policies, on the monetary as well as on the fiscal side. We call this scenario 'Economic Shrinkage' but it is not marked by a double dip (rather by inadequate policy stimulus).

Asset class	Shrinkage	Crunch	Strength	Stretch
Equity			**Buy**	Buy
Government Bond		Buy	**Sell**	
Corporate Bond			**Buy**	
Cash	Buy		**Hold**	

Global Scenario

Sovereign risk under the spotlight

The latest developments in the euro area mark a watershed. The convergence of government bond yields in the run-up to the monetary union was remarkable and nobody tried to go against it in the following years. The consensus view was that all member countries were able to manage their budgets competently.

This complacency could not withstand the deepest recession since WWII, whose most visible feature has been a sharp rise in credit default risk. Throughout the downturn, investors have been frightened by a structural rise in corporate insolvency. Even at the height of the panic concerning a new great depression, credit spreads in government bond markets widened by just a fraction of what happened to corporate bonds.

A new thinking has made its way into financial markets of late, with sovereign default risk entering the picture. Early signs came late last year with Dubai's debt standstill but the trouble with Greece's accounts moved it back to the front page, also because of other countries' involvement and the uncertainties about how the euro area actually works in these circumstances.

The euro's recent weakness is a natural consequence. The disagreement over who should help Greece avoid a default (if any) is damaging the single currency's claim as an alternative reserve currency, but the risks to economic growth are also weighing it down. Countries such as Greece, Spain and Portugal are being urged to put their accounts in order not only by other member states but also by financial markets (often dubbed speculators in the current climate). Structural measures may include deep spending cuts, which are likely to curb household spending. Overall, growth would suffer as a result, but a lack of action would probably meet such a negative response from bond investors that sovereign spreads could soar to levels once associated with more exotic areas.

The crisis in Greece and other "peripheral" countries in the euro area is making the distinction between developed and emerging bond markets an obsolete one. The latter have already broken links with the riskiest (high-yield) segment of credit markets. The average risk premium for emerging countries is now entering the territory of euro peripherals, which are part of the developed world according to old labels.

In another twist of change, the insolvency risk of some peripheral countries is not lower than that of highly-rated corporate issuers. This convergence sounds excessive but is not unreasonable. Companies have dealt with the recession by cutting costs and returned to profitability last year with a much improved cash-flow profile, lessening the risk of insolvency. On the other side, government finances have deteriorated because of the huge size of economic rescue plans, even leaving out the worst examples of budget trickery.

Reassessing the Credit Risk

Source Bloomberg as of 12 March 2010

Regaining the confidence of financial markets will not be easy and the deepest budget cuts are unlikely to be peacefully accepted. Household spending has rarely been a key contributor to overall economic growth and premature fiscal tightening may hurt an already-fragile recovery. The role of exports would be exalted as a result, which calls for a competitive currency.

With all this in mind we have strengthened our positions in favour of non-European equity markets.

Government Bonds

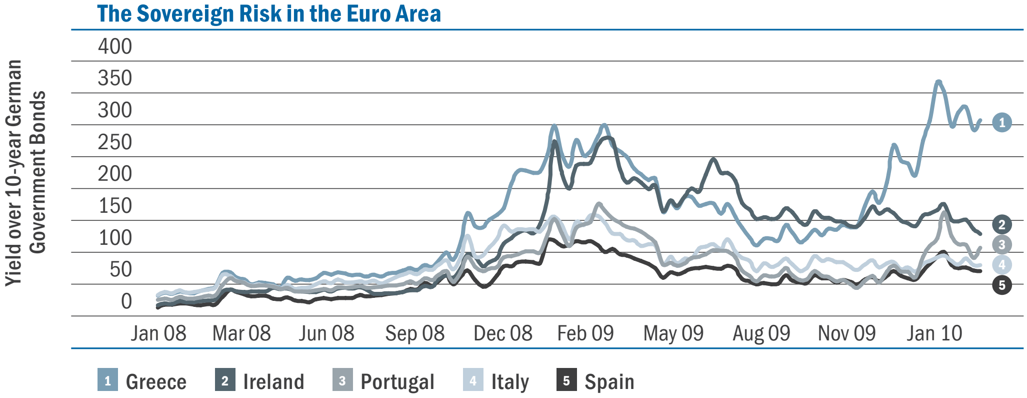
Germany's safe-haven status should not be overrated

The renewed emphasis on sovereign credit risk adds to yield spread volatility within the euro area, while at the same time, corporate bond markets prove resilient. Greece remains in the spotlight and the positive response to the third fiscal plan recently submitted left spreads much closer to highs than to the levels seen before the real crisis erupted last December. This suggests a short-covering rally that will not provide genuine buying opportunities. In this environment, we reiterate our caution on peripheral euro countries' debt. Concerns about how the deepest spending cuts will be implemented seem justified amid social tensions, and not only in Greece.

Our underexposure to peripheral markets does not prompt us to look for a safe haven in core markets, such as Germany, which bear a different risk. Yields have been kept artificially low by very loose monetary policies and they are not too far from last year's lows, as if the economy was still in the midst of a recession. Unwinding these policies may undermine market support and put upward pressure on yields.

The euro does not look overly dependent on central bank purchases (an example of uncoventional monetary policies) and yields may rise slowly if, as we expect, weak consumer spending keeps inflation at bay. However, we should not neglect the downside of a bond market as these operations suddenly come to an end, with UK Gilts providing the best case in point. Therefore, we reiterate our global underweight in government bonds, which extends to the euro area.

The Sovereign Risk in the Euro Area



Source Bloomberg as of 12 March 2010

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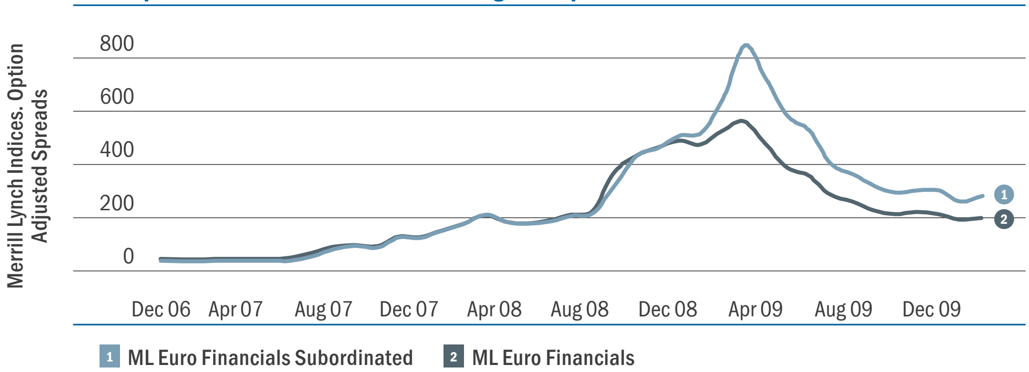
Credit Markets

Resilience, and for a good reason

We reiterate our overweight in non-government markets and notably in investment-grade corporate bonds, although we do not expect a further tightening of credit spreads. Companies' efforts to cut costs throughout the recession helped to regain profitability sooner than expected, but there is still a lot of caution before reviving investments. This approach will maintain a safe cash-flow profile, which satisfies most creditors (even more than shareholders) and leaves the insolvency risk pretty low. Corporate spreads held reasonably well amid the latest turbulence in peripheral bond markets, which is explained by investors' renewed attention to fiscal policies. The ensuing yield convergence looks fundamentally justified.

Corporate spreads are still attractive in the shorter end of the curve, where we can rely on a reasonably attractive carry trade with a good risk/reward ratio. Elsewhere on credit markets, there is still some room for spread tightening in the US where the expected default risk still looks too high after companies' belt-tightening. This market also leaves room for successful stock picking, unlike the high-yield segment which, as an asset class, looks less-than-fairly valued after the unprecedented rally of the last 12 months (which followed, admittedly, the unprecedented slump of 2008). This reasoning also applies to subordinated debt in Europe, issued mostly by banks whose expected turnaround thanks, to the end of the recession, pushed yields sharply down to much less appealing levels.

European Subordinated Bank Debt Closing the Gap



Source Bloomberg as of 05 March 2010

United States

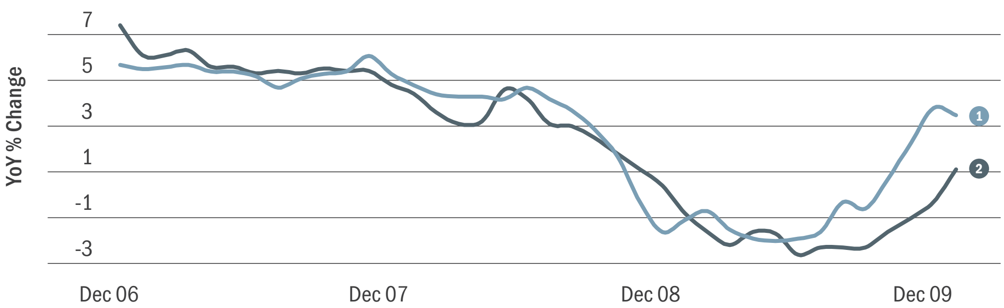
As the economy improves the central bank normalises policy

The recession is over according to the most conventional measures. Not only did the economy manage to grow for two consecutive quarters, but the crucial year-on-year comparison also rose above zero. What is still missing is the return to the levels seen before the crisis in US dollar terms. This further step will take some time as government stimulus measures bolstered GDP growth and allowed the economy to overcome the recession before time, but these will be wound down this year.

We have long challenged the consensus view that the US economy cannot move to a higher gear without the government stimulus. The weakness in labour markets is often quoted as a negative but we should not read too much into a stubbornly high unemployment rate, as other leading indicators are moving upwards. One of them is the number of temporary workers, which has been rising since the third quarter of last year. Companies have not run out of options to cut costs to restore profitability, but they are not retrenching as in the midst of the recession. Most of the recent growth surprises came from inventory restocking but investments in human resources (temporary as they may be) will follow closely. The number of applications for jobless claims is also falling to levels that have often been consistent with overall job creation. We have, therefore, upgraded our estimates for US GDP growth as household spending will make a stronger contribution thanks to better employment prospects. We expect the US economy to grow by 3% this year, which is a performance almost in line with the long-term trend (say the last 50 years). A recent survey by a leading US business daily showed that this has become the consensus view among 54 participants.

A stronger economy would call for the removal of the loosest policies that were enacted at the peak of the crisis, starting with the monetary side. So far the Federal Reserve (Fed) has stopped short of lifting key interest rates but other unconventional measures are being wound down. This goes for the unprecedented amount of money made available to avert the failure of financial firms other than Lehman Brothers. The Fed has already closed most of its emergency liquidity programmes and others will be terminated soon. The increase in the official discount rate is consistent with this withdrawal schedule and is not a restrictive move. The Fed will be in no hurry to shelve all of its bond purchase programmes as long as inflation pressures remain subdued.

Government Incentives Boost US Household Spending



1 US Personal Consumption Expend   2 US Personal Income YoY SA

Source Bloomberg as of 05 March 2010

US Equities

The further increase in our strategic allocation in the US stockmarket is motivated by the strengthening of the economic situation, which should improve the profitability of companies and sectors reliant on domestic demand. The opposite holds true for Europe where fiscal belt-tightening may hurt the domestic source of growth.

This choice does not change our selective approach. We reiterate that last year's gains are unlikely to be repeated. The sharp recovery had been fuelled by an excess liquidity that was made available to the Financials sector to avert a systemic failure. As a result of that rally, most valuation yardsticks related to the S&P 500 Index have become less attractive. A price–to-earnings ratio of 18 is the highest in seven years and suggests a pretty ambitious profit growth.

We are particularly cautious on banks. The risk of further large write-downs is subdued but only those with an adequate capital base are likely to return to a decent level of profitability, and they are still a minority.

The outlook has improved for other cyclical sectors, including those which rely on household spending as buoyant data on retail sales suggest that the economy is less dependent on incentives than most analysts thought. However, we place more emphasis on individual rather industry selection. We prefer companies that are more exposed to strong-growth areas in emerging countries with orders for capital goods, while the recent rebound in the US dollar could make exporters of consumer goods less competitive.

Europe

Fiscal tightening may bite

The policy stimulus enacted in most of Europe was broadly similar to the US and other developed countries. The recovery came almost at the same time but, after some early growth surprises in the middle of last year, Europe's growth estimates have not improved. Comparing GDP growth data on both sides of the Atlantic is hard to do, if only because of different statistical rules. Moreover, US data are often affected by the volatile inventory cycle. The US economy is admittedly more responsive than Europe's to (positive or negative) shocks but in this case Europe's problems can be blamed on uneven growth among countries.

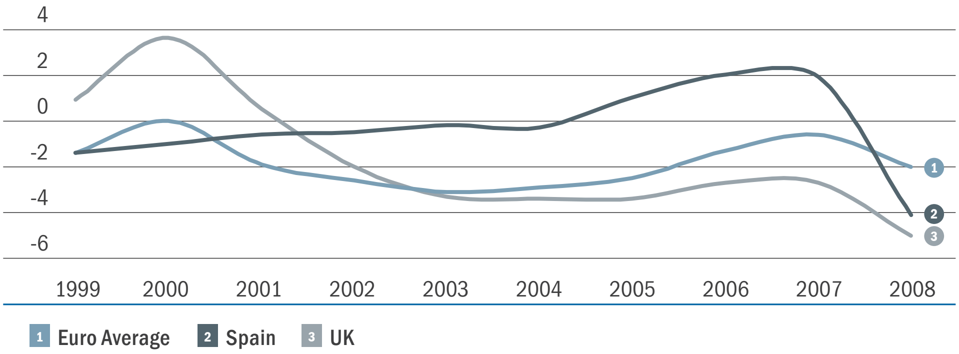
This goes especially for the euro area, where a few "peripheral" countries are struggling to overcome the recession. Euro-wide GDP rose slightly in the fourth quarter of 2009, but the economies of Italy, Spain, Greece and Portugal contracted further. The latter three may find the return to growth a difficult task because of impending fiscal tightening. The contribution to the overall growth of consumer spending, which had never been very strong since the EMU started, may be hit hard by deep spending cuts and other austerity measures. That is the main reason why we refrained from raising the growth estimates for Europe in spite of our improved call on the US economy. We still expect the euro area to grow by 1.5% this year, having suffered a 4% slump in 2009.

As a result, there is no sign of renewed inflation pressures. The latest data for February were even lower than expected, with a year-on-year gain in consumer prices at 0.9% on average in the euro area, in spite of oil and other commodities' recent rise in prices. The core index, excluding food and energy items, is also at 0.9% but this reliable measure of the underlying trend is steadily declining and has just set a record low. The European Central Bank (ECB) has already set a withdrawal schedule for the unconventional policies spurred by the need to fight the recession, but there seems to be no need to push this exit strategy in this environment.

The ECB may be more demanding of high-deficit countries. Throughout the downturn, the budget rules set for euro members were clearly waived but, with global conditions improving, policymakers want to show renewed attention on fiscal policies. The latest plan unveiled by the Greek government was more convincing but it still relies too much on upbeat growth forecasts. A longer recession would make it hard to improve government finances through increased tax revenues.

Also, outside the eurozone there are countries, like the UK, which will have a tough time despite a more lively contribution from household expenditure. Government finances deteriorated sharply as a result of the recession, and a massive deficit-cutting effort is awaited by the next cabinet.

Deteriorating Finances in Some European Countries



Source Bloomberg as of 05 March 2010

European Equities

Most valuations remain cheap: that goes especially for the price–to-earnings ratio but the price-to-cash flow ratio is also still further from 2007 levels than in other markets. The comparison between dividend yields and bond yields provides similar results, thanks to the exceptionally low level of short-term bond yields, which were kept low by overly expansionary monetary policies. If, as we expect, inflation pressures remain subdued, this assessment will hold true.

In absolute terms, the strong correlation with the US market seen during both the recession and the subsequent recovery last year is supportive. Our latest move to add to the US exposure and cut Europe's is based on macroeconomic reasons, as growth in Europe looks more at risk from premature government spending cuts to redress excess budget deficits. This warning does not prevent the sectors that are more reliant on foreign demand exploiting better global conditions, especially if they are exposed to Emerging Markets.

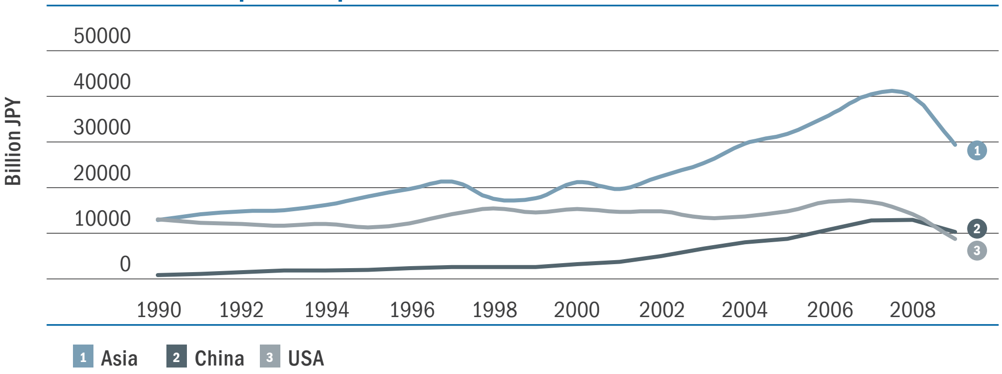
Japan

Exports support growth

Private demand has not recovered the levels seen before the crisis. Therefore, exports accounted for much of the overall economic improvement. A clear example of a sharp (V-shaped) recovery is provided by the upturn in industrial production. With the January gain, this indicator has scored the longest winning streak in 12 years. The decline in the inventory-to-shipment ratio is also remarkable: this key gauge is almost back to equilibrium levels, meaning that any increase in orders will increase production. Surrounding areas, with China in the first tier, have accounted for a large part of industrial orders since the recovery began.

The government is not happy with export-driven growth but reviving household spending is not easy with the policy tool-kit that is currently available. Government finances are already overstretched with excessive debt-to-GDP and deficit-to-GDP ratios, and that leaves little room for fiscal expansion. Little help comes from the labour market, where the improvements are progressing slowly from crisis levels (in terms both of wage growth and employment rates). Against this backdrop, the zero-rate policy of the central bank looks the only tool to stimulate the economy. The persistence of a deflationary environment makes this policy sustainable in the long run. It has been almost a year since the key inflation rate (excluding fresh food) tracked by the central bank stayed above zero.

Asia's Role for Japanese Exporters



Source Bloomberg as of 05 March 2010

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Japanese Equities

The fragile macroeconomic outlook prompts us to overlook the Japanese market in our allocation strategy, comparing its macroeconomic downside risk with that of Europe.

Like Europe, this market looks cheap by many valuation yardsticks. Japan's attraction last year came from very attractive price-to-book ratios but we have not yet entered that area. When that happens, the market is able to withstand global trends and show a low correlation with other key indices.

At sector level, the best opportunities arise for major exporters, particularly of capital goods to emerging countries, while we are more cautious on producers of consumer goods. Carmakers have been helped by government stimulus measures and are unlikely to follow up on last year's recovery. Furthermore, Toyota's product recalls have already hurt the stock but reliability problems at other carmakers may prompt doubts about corporate governance elsewhere.

Asia and Emerging Economies

The need to watch inflation

Even in areas with a strong domestic growth potential, governments enacted some stimulus policies to get their economy back to a sustained growth path. China is a case in point, with central authorities pushing state-owned banks to lend money to the largest (and mostly state-owned) companies. Bank lending growth grew as much as 35% year-on-year until last November but the need to avoid a rise in non-performing loans prompted the central bank to tighten up, first by telling banks to cap credit growth and then by raising interbank rates and/or reserve requirements.

Government intervention quickened the return to double-digit GDP growth rates in China. Industrial output grew steadily and recouped in January all of the losses suffered in the midst of the crisis. In February, it rose less than expected, but data in this period are hard to interpret because of new-year celebrations, which affect overall economic activity. Investments accounted for most of GDP growth, a pattern which marked past economic expansions and is partly justified by the need to build infrastructure. Some excesses will have to be pared by the withdrawal of most stimulus measures.

The government's exit strategy will be pursued gradually if inflation remains under control. We believe that it started in time to prevent the economy from overheating, although we will monitor inflation closely. In February, consumer prices rose more than expected and with a year-on-year rate of 2.7% they made real one-year bank deposit rates negative. Other Emerging countries are dealing with an acceleration in inflation: India's key gauge is the Wholesale Price Index, which rose to a 15-month high of 8.5% in January. In both countries, central banks are acting softly so far and are likely to do so until property prices show little evidence of a bubble in the making.

Other areas, Developed and Emerging as well, are directly affected by growth in China. Japan is a case in point among developed countries, while in Latin America it is Chinese demand for resources to feed commodity exporters (which account for a large part of corporate and government revenues there). Brazil benefited both from being a net exporter of industrial metals and from sound economic policies, which helped it to overcome a shallow recession. Inflation is not yet a problem, although the central bank is closely watching the situation as the government upgraded this year's economic growth to 5%.

The proximity to areas with a strong growth potential is key for developed as well as developing countries. Eastern Europe, with the exception of Russia, which is a major exporter of commodities, looks uncomfortably close to Western Europe's low-growth areas. Some of these countries, such as Hungary and the Baltic states, were hard-hit by the recession and are still posting quarterly GDP declines. Equity markets have rebounded strongly over the last 12 months amid the global rally but this confidence may be premature for most of this region.

Watching Inflation in China

Source Bloomberg as of 12 March 2010

Emerging Equities

China's key role as the engine of economic growth keeps investors' on alert about the authorities' efforts to cool the excessive growth of bank lending, which, if not properly controlled, could bring an increase in bad loans. The tools adopted so far are conventional and do not suggest a restrictive policy stance: the benchmark interest rates were raised slightly and the same applies to the reserve requirements of banks.

Withdrawing the most stimulative measures is part of a scheduled exit strategy and will be pursued gradually if inflation, as we still expect, does not rise sharply. Countries where food accounts for a high stake of consumption patterns are more at risk of a sudden spike in prices and, therefore, the current optimism will be tested on a continuous basis. We reiterate our view that the Chinese authorities have moved pre-emptively, which should contain the risk of overheating. In real estate, prices have risen steadily but there is little evidence of a bubble in the making.

For our specialists the country allocation is important. Areas with stronger potential for growth may attract more foreign investment flows and that would be market supportive. However, alongside this criterion we also stress the need for individual selection. Here, such factors as the quality of management and shareholders' protection play as much of a role as in developed countries' stock portfolios.

Currencies

Euro in the spotlight, along with the British Pound

Our latest strategic moves have added to our US dollar allocation. We are not overly concerned about that, as we believe that better growth prospects for the US economy have eventually been priced in.

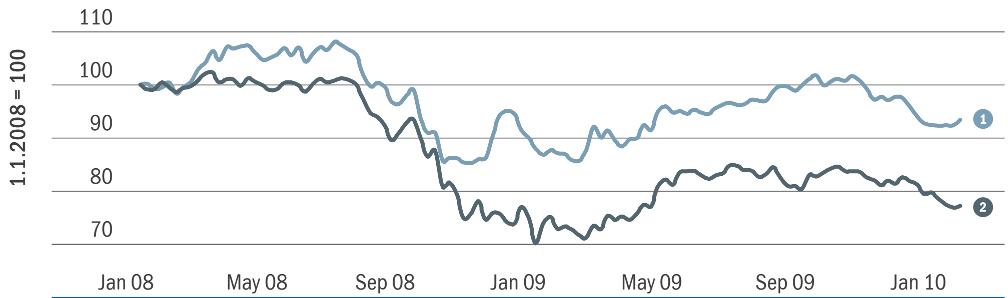
Until late November 2009 the euro seemed to be the best alternative to the US dollar as a reserve currency amid fears about the excessive US budget deficit and foreign creditors' propensity to fund it. The problems of Greece have highlighted a few glitches in the eurozone's provisions to deal with a financial crisis involving any member countries. The need to restore credibility in financial markets will prompt tighter fiscal policies with spending cuts weighing on consumer spending. This leaves exports as an alternative source of growth and a weaker euro currency will act as a proper stimulus on that side.

Speculative flows may have indeed driven currency markets of late. Politics also come into play, as the involvement of the British Pound in this year's turbulence suggests. The prospect of a hung Parliament in Britain is a negative for the currency because it undermines the commitment to cut the budget deficits.

The US dollar is not out of the woods despite exiting the spotlight. The federal budget deficit is still too high for comfort and foreign investors still account for most of the funding. They expect more commitment from US officials to cut it or, at least, to contain it over the next few years. The ruling party's latest setbacks may spur some bipartisan agreement towards budget consolidation, but in an election year the most radical measures are likely to be avoided.

The lack of alternatives for a reserve currency in the wake of the euro's recent woes may sustain the US dollar. The yen is unlikely, too, to strengthen as long as Japan's economy is haunted by deflation and the central bank's commitment to a zero-rate policy leaves it as the sole funding currency for carry trades among the majors.

Euro and British Pound Under Pressure



1 Euro Spot 2 British Pound Spot

Source Bloomberg as of 12 March 2010

Tactical Asset Allocation Summary

Equities: Overweight

Our improved estimate for US economic growth prompts us to restore a global equity overweight as it enhances our base scenario of 'Economic Strength'. Growth in corporate earnings will continue in 2010 and will eventually get stronger when sales revenues rise as well. We are increasing our holdings in the most growth-responsive areas, while we are less confident on Europe and Japan.

USA: Overweight

UPGRADED. We concede that the recovery will not be as quick as after the end of past downturns, as consumer spending remains subdued in a weak labour market. However, jobs may be created again earlier than consensus expectations. Companies are hiring temporary workers in spite of cost-cutting plans and jobless claims are declining more speedily. This may lead to renewed growth in sales revenues, which will add to earnings on top of cost cutting.

Europe: Underweight

DOWNGRADED. We are not overly optimistic about Europe's economic prospects despite the benefits of a stronger US economy. Cyclical sectors stand to benefit from improving global economic conditions with less downside risks to earnings. Industrial companies with a strong exposure to developing countries' demand for capital goods meet these requirements, with a recovery in earnings per share less affected by the mixed outlook for Europe's domestic demand (which may also be hurt by prematurely restrictive fiscal policies).

Japan: Neutral
After a dramatic underperformance valuations look compelling, but the burden is on the central bank to get the economy out of recession. This reminds us of the indefinitely loose policy of the lost decade (the 1990s), which left the market lagging behind global trends most of the time. Export-oriented sectors can have earnings per share enhanced by their exposure to global growth, particularly to demand from the rest of Asia.

Pacific ex Japan: Underweight
In terms of regional stock indices, this area is not centred on East Asia's most dynamic countries, such as China. Australia accounts for a large part of them and within it much of the recent performance came from miners and other basic-resources companies, whose earnings expectations already look overstretched, in spite of their exposure to strong developing markets in Asia.

Emerging Markets: Overweight
Emerging markets magnify global trends and stand to benefit from our improved call on the US economy. We are particularly confident on the regions where domestic demand is a key driver of growth and without serious current-account imbalances. Most of emerging Asia meets this requirement, although China's attempts to check growth in bank lending may prompt increased volatility. However, we believe that China is acting pre-emptively to head off a speculative bubble in asset prices.

Fixed Income: Underweight
Government bonds look expensive and account for our global underweight. Yields are being kept down across the curve by loose monetary policies but governments' reluctance to reduce the budget deficits may prompt more issuance and eventually put upward pressure on yields.

We confirm our overweight in credit markets, with the best opportunities in the investment-grade segment where the risk/reward ratio is not higher than for the government bonds of the most deficit-prone countries.

Euro Government: Underweight
Inflation does not pose a problem and the European Central Bank (ECB) is set to withdraw unconventional policies gradually. Yields are too low in core markets, such as Germany, amid the current turmoil in Greece and other peripheral countries, and they are also prone to an upward correction because of the US market's role as a global trend-setter.

Euro Corporate: Overweight
Credit spreads have dropped sharply and should have little room left for further tightening. We see the better risk/reward ratio at the short end of the investment-grade segment on a selective basis, as government yields are kept artificially low by policies of quantitative easing. We retain an overweight in this asset class also as a result of the recent volatility in government bond markets, where sovereign default risk has been revived by the problems of Greece.

US Government: Underweight
The US Federal Reserve's quantitative easing has kept yields lower than a recovering economy would imply. Foreign investors will be key in funding the deficit and without convincing plans to cut it they may remain nervous about a resurgence of inflation. However, we do not anticipate a sharp rise in bond yields as a growing political consensus about budget consolidation may be found before the November mid-term elections.

US Corporate: Overweight

The drop in credit spreads has been considerable and leaves little room for further tightening, especially in the high-yield market. For its part the investment-grade segment retains some value as companies, which cut costs aggressively, have improved their cash flow profiles.

Emerging Markets: Neutral

We are ready to upgrade this class, which bears a lower risk than high-yield markets. Moreover, the renewed uptrend in commodity prices supports the finances of countries, notably in Latin America, that are net exporters of raw materials and accounts for a large stake of this market. Finally, sound economic policies will lead to a steady decline in credit risk over time.

Tactical Asset Allocation Summary

Global Summary Table

Asset Class	Recommendation
Equity	Overweight
Government Bonds	Underweight
Corporate Bonds	Overweight
Liquidity	Overweight

Regional Summary Table

Asset Class	Recommendation
Euro Cash	Underweight
2yr Euro Corp	Overweight
Total Liquid Assets	**Overweight**
Euro Bond	Underweight
US Bond	Underweight
Japan Bond	Underweight
Government Bonds	**Underweight**
US Corporate	Overweight
US High Yield	Neutral
Euro Corporate	Overweight
Euro High Yield	Neutral
Emerging Market Bonds	Neutral
Corporate Bonds	**Overweight**
North America Equity	Overweight
Europe Equity	Underweight
Japan Equity	Neutral
Global Emerging Mkts	Overweight
Pacific Ex Japan	Underweight
Equity	**Overweight**

Foreign Currency Exposure

US Dollar	Overweight
Euro	Underweight
Yen	Neutral
Other	Neutral

FROM WEAKEST TO STRONGEST IN ASCENDING ORDER:

Strong Underweight	Underweight	Slight Underweight	Neutral	Slight Overweight	Overweight	Strong Overweight

Please note that the rank is indicative and may not balance when summed.

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